From:	Kevin Prendergast
To:	Kevin Prendergast
Subject:	Midterm Election Quick Reaction
Date:	Wednesday, November 7, 2018 5:48:08 PM
Attachments:	image003.png

EFG Family and Friends,

Hope your week is going well.

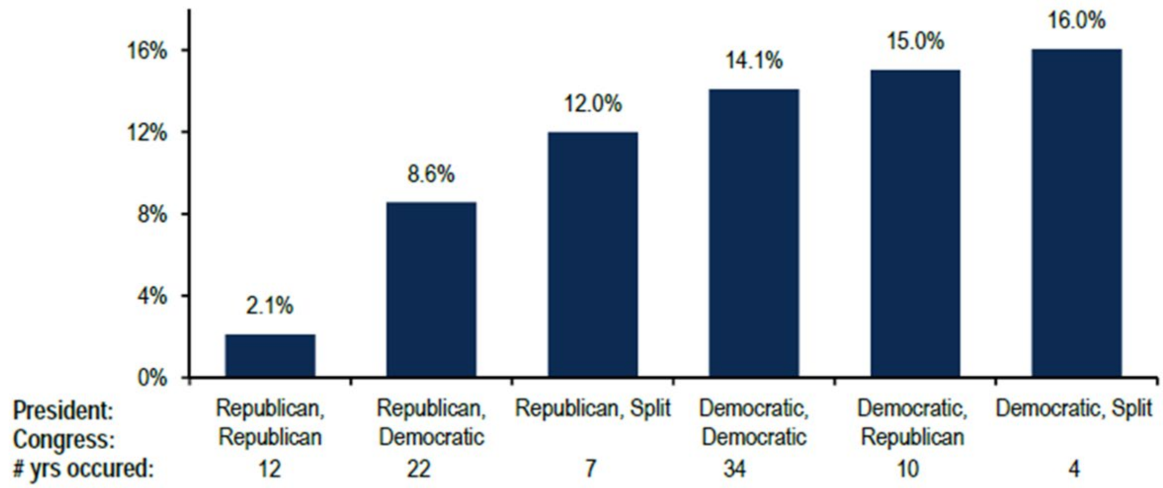
The contentious 2018 midterm elections are in the books and Democrats will occupy a majority of House seats. Hopefully election handicappers like Nate Silver of FiveThirtyEight (ABC/ESPN) can finally get some sleep. As of the time of writing, about 6AM Central on November 7th, Nate was still tweeting away as recently as 3 hours ago!

For proponents of small government, this election result could be viewed as a positive, in that a divided Congress is less likely to make sweeping changes that challenge our capital market assumptions. To that point of view, we attended a presentation by the always optimistic Ed Yardeni last week, who reminded the audience that a different way to say “gridlock” with a more positive connotation is “balance of power.” With that said, perhaps a Democrat-controlled House does little to alter our present course, given that many policy decisions are made by Executive Order.

Putting our feelings on the balance of power aside, as students of history, we like to examine the past to help guide our expectations for the future. The chart below is making the rounds on social media, demonstrating the performance of the S&P 500 (Large US Stocks) for all possible combinations of the Executive and Legislative branches under our two-party system over the past 90 years. The evidence indicates that in many cases, a divided US government coincided with stock market returns exceeding the long-term average return of 9-10% per year. If American politics were the only factor influencing stock market returns, we might take the evidence below to be a ringing endorsement for US Stocks. Of course, if we’re being honest, it’s unclear how actionable the information in this chart is for us as investors. After all, we’re not going to turn down 8.6% or even 2.1% returns in a world where cash generally pays us less than 2%!

Chart 10: Equity markets have generally thrived under gridlock in Washington

Avg. annual S&P 500 total returns based on control of White House & Congress, 1928-present



Note: Excluding 2008, average for Republican President, Democratic Congress is 10.2% (still the second-weakest period). Total returns 1936-prsent and price returns prior to that.

Source: S&P, FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

Our general outlook is unfazed by the election result. In the decades ahead, we remain most focused on debt and deficits, which continue to grow unchecked in both the government and non-bank corporate sectors globally. It would be foolish to say we know with certainty how extreme levels of debt will impact the global markets long-term, because there is not a clear precedent. Will the outcome be deflation? If so, we'll likely want to own cash, high quality bonds, and other fixed income streams. Will the outcome be inflation? If so, we'll likely want to own stocks, real estate, and commodities. We're expecting Ray Dalio's new book on the subject to arrive at our office any day now, and we're very interested to see what he has to say. The refrain you will continue to hear from us is "now is not the time to be making big bets," and selling all of our investments to go to cash is just as much of a bet as putting all of our money in the S&P 500. Now is a time to remain disciplined and diversified, even when it may be difficult to do so.

Please let us know if we can be of additional service.

Best,

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